

REPORT OF
ASSOCIATION EXAMINATION
OF
PROTECTIVE LIFE AND ANNUITY INSURANCE
COMPANY

BIRMINGHAM, ALABAMA

AS OF
DECEMBER 31, 2003

PARTICIPATION:
SOUTHEASTERN ZONE
ALABAMA

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April 29, 2005
Birmingham, Alabama

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COMMISSIONER

DEPUTY COMMISSIONER
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JAMES R. (JOHNNY) JOHNSON

CHIEF EXAMINER
RICHARD L. FORD

ACTING STATE FIRE MARSHAL
RICHARD MONTGOMERY

GENERAL COUNSEL
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RECEIVER
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Jim Morrison, Commissioner
Department of Insurance
State of Montana
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Dear Commissioners:

Pursuant to your authorizations and in compliance with the statutory requirements of the State of Alabama and the resolutions adopted by the National Association of Insurance Commissioners (NAIC), an examination has been made of the affairs and financial condition of

Protective Life and Annuity Insurance Company
Birmingham, Alabama

at its home office located at 2801 Highway 280 South, Birmingham, Alabama 35223, as of December 31, 2003. The report of examination is submitted herewith. Where the description "Company" or "PL&A" appears herein without qualification, it will be understood to indicate Protective Life and Annuity Insurance Company.

**STATE OF ALABAMA
COUNTY OF JEFFERSON**

I, Palmer W. Nelson, being first duly sworn, upon his oath deposes and says:

That he is an examiner appointed by the Commissioner of Insurance for the State of Alabama;

That an examination was made of the affairs and financial condition of Protective Life and Annuity Insurance Company for the period of January 1, 2000, through December 31, 2003;

That the following 58 pages constitute the report thereon to the Commissioner of Insurance of the State of Alabama;

And that the statements, exhibits, and data therein contained are true and correct to the best of his knowledge and belief.



Palmer W. Nelson, CFE

Subscribed and sworn to before the undersigned authority this 29th day of April 2005.



(Signature of Notary Public)

Janice L. Thomas, Notary Public
(Print Name)

in and for the State of Alabama.

My commission expires 9-16-08.

SCOPE OF EXAMINATION

The Company was last examined for the five-year period ended December 31, 1999, by examiners from Alabama, representing the Southeastern Zone, NAIC. The current examination covers the intervening period from the date of the last examination through December 31, 2003, and was conducted by examiners from Alabama, representing the Southeastern Zone, NAIC. When deemed appropriate, transactions subsequent to 2003 were reviewed. The examination was made in accordance with the statutory requirements of the Alabama Insurance Code and the Alabama Insurance Department's regulations and bulletins; in accordance with the applicable guidelines and procedures promulgated by the NAIC; and in accordance with generally accepted examination standards and practices in connection with the verification of assets and determination of liabilities.

The examination included an inspection of corporate records, test checks of recorded income and disbursement items for selected periods, and a general review of records and files pertaining to operations, administrative practices, and compliance with statutes and regulations. Assets were verified and valued and all known liabilities were established or estimated as of December 31, 2003, as shown in the Financial Statements contained herein. However, the discussion of specific assets or liabilities contained in this report is confined to those items where a change was made by the examiners, or which indicated violation of the Alabama Insurance Code and the Insurance Department's rules and regulations or other insurance laws or rules, or which are deemed by the examiners to require comments or recommendations.

Company office copies of the filed Annual Statements for the years 2000 through 2003 were compared with or reconciled to account balances with respect to ledger items.

The market conduct review consisted of a review of the Company's plan of operation, territory, policy forms and underwriting practices, advertising and marketing, claims, policyholder complaints, agents' licensing practices, and compliance with privacy standards.

PriceWaterhouseCoopers, LLP and the Internal Audit Department of the parent company, Protective Life Insurance Company (PLIC), perform the internal audit function and are subject to an internal audit oversight committee. The Company's accounts were examined by PriceWaterhouseCoopers, LLP,

certified public accountants (CPA's), for each of the four years under examination. The examiners reviewed and used, where deemed appropriate, the CPA audit reports and certain CPA work papers related to controls testing.

A signed certificate of representation was obtained during the course of the examination. In this certificate, management attested to having valid title to all assets and to the nonexistence of unrecorded liabilities as of December 31, 2003.

ORGANIZATION AND HISTORY

The Company was incorporated as Alabama Foundation Life Insurance Company under the laws of the State of Alabama on November 20, 1978, in order to change its state of domicile to Alabama. Before the change of domicile, the Company was American Foundation Life Insurance Company, an Arkansas insurer, which was originally chartered by Arkansas on July 7, 1955, as Pioneer Western Life Insurance Company (Pioneer Western).

Pioneer Western was licensed by Arkansas on July 12, 1955, and commenced business September 1, 1955. On December 31, 1960, American Foundation Life Insurance Company of Arkansas was merged into Pioneer Western, at which time the name was changed to American Foundation/Pioneer Western Life Insurance Company. The name American Foundation Life Insurance Company was adopted July 1, 1963.

Under the terms of a merger agreement dated November 22, 1978, redomestication to Alabama was accomplished. The Company then assumed the name American Foundation Life Insurance Company. The capital of the Company was \$1,000,000, with 100,000 shares of \$10 par value common stock authorized, issued, and outstanding. Capital was increased on September 30, 1980, to \$1,200,000 as the result of a \$200,000 (20,000 shares of \$10 par value common stock) stock dividend. Also during 1980, the Company received a surplus contribution of \$2,285,419.

The Company merged with American Sentinel Life Insurance Company, a South Carolina corporation, effective January 1, 1981. The name of the surviving company remained American Foundation Life Insurance Company.

On September 19, 1983, the Alabama Department of Insurance approved the acquisition of the Company by Protective Life Corporation (PLC), then known

as Protective Corporation, and its subsidiary Protective Life Insurance Company (PLIC). Immediately prior to this acquisition, the Company's capital was increased by the issuance of a new class of \$1 par value redeemable participating preferred stock, of which 2,000 shares were issued as a stock dividend. The transaction was recorded by crediting paid-in capital with \$2,000 and paid-in surplus with \$1,998,000.

The participating preferred stock had a mandatory redemption provision requiring redemption on September 30, 1991, for \$2,000,000. This redemption period was extended on September 25, 1991, for an additional five-year period, or until September 30, 1996. The Company amended the preferred stock to remove the maturity date and changed the language in the stock issue to reflect that the stock was redeemable only at the discretion of the Company.

As provided for in the stock purchase agreement dated August 29, 1983, Protective Corporation purchased the participating preferred stock and PLIC purchased the common stock.

Pursuant to the stockholder's resolution dated December 30, 1983, the Company's authorized capital was increased to \$2,002,000, consisting of 2,000 shares of \$1 par value preferred stock, and 200,000 shares of \$10 par value common stock. PLIC was granted the additional authorized 80,000 shares of common stock "...in consideration of \$800,000 of \$1,489,566 contributed to the surplus...as authorized on November 2, 1983..." Capital stock of the Company authorized, issued, and outstanding remained constant at 2,000 shares of \$1 par value participating preferred stock, and 200,000 shares of \$10 par value common stock until July 15, 1998, when the Company's Board of Directors increased the number of authorized shares of common stock from 200,000 shares to 500,000 shares. On August 18, 1998, the Company's Board of Directors declared a 25% stock dividend, thereby increasing the total issued shares of common stock to 250,000 shares, or \$2,500,000 par value.

Due to a partial liquidation distribution to the previous owner of the Company and a surplus contribution in 1983, the Company's paid-in and contributed surplus was reduced to \$6,200,000. During the period covered by the preceding examination, the Company received a \$100,525,865 capital contribution resulting in a year-end 1999 balance of \$106,725,865. The Company received a capital contribution of \$70,000,000 during 2002, and the balance at year-end 2003 was \$176,725,865. The Company reported in its 2003 Annual Statement unassigned funds of \$(70,496,363) and special surplus funds

of \$6,815. The Company's total reported surplus as of December 31, 2003, was \$106,236,317.

The purposes and objectives of the Company, as stated in the Articles of Incorporation, as amended, shall be to:

...engage in any lawful business...and to transact the business of life, disability, health and accident insurance and to issue annuities and endowments and every other kind of insurance in such places as may be approved by the Board of Directors, subject to applicable regulatory approvals....

MANAGEMENT AND CONTROL

Stockholders

The By-Laws, as amended, provide that the annual meeting of the stockholder is for the purpose of electing directors and for the transaction of such other business as may come before the meeting and shall be held at such date and time during the first six months of the year as shall be specified by resolution of the Board of Directors. Special meetings may be called for any purpose by the Board of Directors, the President, or the Chief Executive Officer.

Board of Directors

Members elected on May 12, 2003, to the Board of Directors by the sole stockholder and serving at December 31, 2003, were as follows:

<u>Director/Residence*</u>	<u>Principal Occupation</u>
Richard Joseph Bielen Birmingham, Alabama	Senior Vice President, Chief Investment Officer, Protective Life Corporation
Robert Stephen Briggs Birmingham, Alabama	Executive Vice President, Life and Annuity Division, Protective Life Corporation
Joseph William Hamer Birmingham, Alabama	Senior Vice President, Information Systems, Protective Life Corporation
John Dixon Johns Birmingham, Alabama	President, Chairman of the Board, Chief Executive Officer, Protective Life Corporation
Thomas Davis Keyes	Senior Vice President, Information

Birmingham, Alabama	Systems, Protective Life Corporation
Carolyn King Birmingham, Alabama	Senior Vice President, Acquisitions, Protective Life Corporation
Deborah Joyce Long Birmingham, Alabama	Senior Vice President, General Counsel, Secretary, Protective Life Corporation
Allen Walker Ritchie Birmingham, Alabama	Executive Vice President, Chief Financial Officer, Protective Life Corporation
Wayne Edmund Stuenkel Birmingham, Alabama	Senior Vice President and Chief Actuary, Protective Life Corporation

*Jim E. Massengale, Executive Vice President of Acquisitions, was elected as a Director but resigned December 29, 2003.

Committees

The By-Laws state that

The Board of Directors may, by resolution or resolutions adopted by a majority of the full Board of Directors, designate one or more committees, each committee to consist of two or more of the directors of the Company, which, to the extent provided in such resolution or resolutions, shall have and may during intervals between the meetings of the Board exercise the powers of the Board of Directors in the management of the business and affairs of the Company... .

The powers of any committee were restricted with regard to certain powers such as the declaration of dividends, which power was reserved for the Board of Directors. The only committee at December 31, 2003, was the Executive Committee, which is described in the following section.

Executive Committee

The Executive Committee of the Board of Directors shall consist of two or more directors of the Company. The persons are to be elected by the Board to serve until the next annual Board meeting. The Executive Committee, in the interim between meetings of the Board, shall exercise the powers of the Board. It was resolved at the Board of Directors' meeting on May 12, 2003, that the Executive Committee shall consist of two members:

John Dixon Johns
Allen Walker Ritchie

Officers

The following officers were serving as of December 31, 2003:

Wayne Edmund Stuenkel	President, Chief Actuary, Director
Robert Stephens Briggs	Executive Vice President, Individual Life, Director
Allen Walker Ritchie	Executive Vice President, Chief Financial Officer, Director
Steven Glen Walker	Vice President, Controller, Chief Accounting Officer
Richard Joseph Bielen	Senior Vice President, Chief Investment Officer, Treasurer, Director
Brent Edwin Griggs	Senior Vice President, Asset Protection
Carolyn King	Senior Vice President, Acquisitions, Director
Deborah Joyce Long	Senior Vice President, Secretary, General Counsel, Director
Carl Sitter Thigpen	Senior Vice President, Chief Mortgage and Real Estate Officer, Assistant Secretary

Management and Service Agreements

The Company had various management and service agreements in effect with affiliated companies at December 31, 2003. The examination noted that the Company is not requiring its affiliates to comply with a standard provision contained in its Administrative Service Agreements with affiliates. The service agreements contain a paragraph titled "Payment of Charges". The payment of charges provision contains a requirement that the affiliate "...submit to the Company within 15 days of the end of each calendar quarter a written statement of the amount estimated to be owed by the Company for services pursuant to the agreement in that calendar year, ..." The Company did not require its affiliates to provide the estimates as stipulated by the agreements.

The following agreements were in effect at year-end 2003:

Agreement for Investment Services

This agreement was entered into on October 3, 1983, between Protective Life Corporation (PLC) and the Company. An amendment was effective on January 4, 1984.

The term of this agreement was for an initial term of twelve months, beginning October 3, 1983, and shall automatically renew on each anniversary.

Either party shall give the other written notice at least sixty days prior to the end of any term of its intent not to renew this agreement for another term.

The Investment Department of PLC agrees to research and analyze investment opportunities with respect to funds of the Company which require investment or reinvestment and to execute the purchases or sales pursuant thereto. All transactions shall be reported to and are subject to ratification by the Company's Board of Directors. PLC's Investment Department shall be authorized to collect and transmit to the Company any and all amounts paid on such investments, and to manage such investments and reinvestments for the benefit of the Company. The Investment Department of PLC further agrees to provide and maintain documentation necessary for the preparation of accounting records and any required reports needed monthly, quarterly, or as part of statutory annual filings.

Charges for all investment services shall be computed and settled monthly as follows:

<u>Bonds</u>	5 1/2% of interest income collected.
<u>Mortgages</u>	5 1/2% of all income collected on the mortgage loans serviced for PL&A and an additional fee of 1 1/2% of the initial asset value of each new mortgage loan added to the mortgage portfolio of PL&A.
<u>Preferred Stocks</u>	5 1/2% of dividends collected.
<u>Common Stocks</u>	Quarterly fee of 0.125% of the market value of PL&A common stock portfolio at the end of the preceding quarter.

Real Estate

5 1/2% of income received on real estate serviced for PL&A.

Other Invested Assets

5 1/2% of income received.

The above fees do not include third party fees for activities or services rendered on investments such as the contractual service fees to mortgage loan service agents.

Agreement for Legal Services

This agreement was entered into on May 20, 1985, between Protective Life Corporation (PLC) and the Company. An amendment was entered into on October 1, 1987, and another amendment on January 1, 1997. The term of this agreement was for an initial term of twelve months, beginning on May 20, 1985. The agreement shall automatically renew on each anniversary date. Either party shall give written notice to the other party of at least sixty days prior to the end of any term of its intent not to renew this agreement.

PLC agrees to provide legal services for the Company including but not limited to general corporate legal work, insurance related legal work, contracts, litigation supervision, and administrative and other regulatory legal work.

Charges for all legal services provided shall be accumulated and settled monthly at a rate per hour of attorney time as provided in the following schedule:

<u>Position</u>	<u>Rate</u>
Senior Associate Counsel	\$110.00 per hour
Paralegal	\$ 45.00 per hour

The above fee schedule shall be amended from time to time by written agreement between parties.

Agreement for Data Processing Programming Services

This agreement was entered into on November 1, 1987, between Protective Life Corporation (PLC) and the Company.

The term of this agreement was for an initial term of twelve months, beginning on November 1, 1987, and shall automatically renew on each anniversary.

Either party shall give the other party written prior notice of at least sixty days prior to the end of any term of its intent not to renew this agreement for another term.

Appropriate costs of data processing programming services provided by PLC shall be billed by PLC, and the Company agrees to pay at such time and in such amounts as set out by PLC on statements furnished to the Company. Such costs shall be determined by allocating the expenses incurred by PLC for providing the data processing programming services based upon a percentage of the amount of time spent in performing said services for the Company by PLC's personnel multiplied by rates for such services then in effect. These rates may be adjusted at any time by PLC, provided the Company receives a copy of the adjusted rate schedule within thirty days of any such change. Such costs shall be accumulated and settled monthly.

Tax Allocation Agreement

The Company entered into an agreement on January 1, 1988, with Protective Life Corporation (PLC) and the other affiliated companies in the holding company system, for allocating the consolidated tax liability among the affiliated members of the holding company system, for reimbursing PLC for payment of such tax liability, for compensating any party for use of its losses or tax credits, and to provide for the allocation and payment of any refund arising from a carry-back of losses or tax credits from subsequent taxable years. The agreement requires each member of the affiliated group to calculate its tax liability as if it had filed its federal income tax return on an individual basis.

The agreement applied to tax returns beginning with the year ended December 31, 1988, and for all subsequent years. The agreement provided that any additional subsidiaries or affiliates would automatically be included in the agreement. All matters under the agreement, pursuant to the terms of the agreement, would be handled in accordance with the Internal Revenue Code.

Guaranty Agreement

An agreement was signed on October 27, 1993, whereby Protective Life Insurance Company (PLIC) guaranteed that the Company will pay all insurance policy claims made by the holders or beneficiaries of the Company's insurance policies in accordance with the terms and conditions of the policies. PLIC

unconditionally guaranteed the due and punctual payment to the policyholders when and as the same shall be due and payable according to the following:

All obligations of American [the Company] to the Policyholders arising under the terms and conditions of any insurance policies issued by American [the Company] from the date hereof until the date this guaranty is terminated pursuant to the provisions hereof (the "Policies"). It is specifically agreed and understood that this guaranty shall in no way expand the Policyholders' rights, but shall merely guarantee the payment of all amounts otherwise due them pursuant to the terms of the insurance policy they are claiming under.

This agreement shall remain in full force and effect until the earlier of (a) when the Company achieves a claims paying rating equal to or better than the Guarantor or (b) ninety days after it is revoked or terminated by a written instrument, signed by the Guarantor. Even after any revocation or termination by such notice, this guaranty shall be and remain effective as to any policies then outstanding.

The agreement was amended on April 14, 1998, to include the following provision:

This guaranty may be enforced only if American [the Company] is unable to pay its obligations when as they become due, or if American [the Company] in [sic] placed in rehabilitation, receivership, liquidation or similar proceeding. This guaranty may be enforced only by American [the Company] or its successor (including without limitation its rehabilitator, receiver or liquidator).

Administrative Services Agreement
Empire General Life Assurance Corporation

The Company entered into an administrative services agreement with Empire General Life Assurance Company (EG) on October 1, 2003.

EG agrees to provide the administrative services in relation to certain term and whole life insurance business of the Company. These services include marketing, compliance, policyholder, policy issuing, accounting, financial reporting, licensing, commission payments, and underwriting services, and such other services the Company may reasonably request with respect to the business.

The Company agrees to reimburse EG at cost for services and facilities provided by EG. The charge to the Company for such services shall include all direct and indirectly allocable expenses. The agreement can be terminated by either party by giving sixty days prior written notice to the other party.

Administrative Services Agreement
Protective Life Corporation

The Company entered into an administrative services agreement with Protective Life Corporation (PLC) on October 1, 2003.

PLC agrees to provide the administrative services in relation to certain term life insurance business of the Company. These services include marketing, compliance, policyholder, policy issuing, accounting, financial reporting, licensing, commission payments, and underwriting services, and such other services the Company may reasonably request with respect to the business.

The Company agrees to reimburse PLC at cost for services and facilities provided by PLC. The charge to the Company for such services shall include all direct and indirectly allocable expenses. The agreement can be terminated by either party by giving sixty days prior written notice to the other party.

Administrative Services Agreement
West Coast Life Insurance Company

The Company entered into an administrative services agreement with West Coast Life Insurance Company (WCL) on October 1, 2003.

WCL agrees to provide the administrative services in relation to certain term and universal life insurance business of the Company. These services include marketing, compliance, policyholder, policy issuing, accounting, financial reporting, licensing, commission payments, and underwriting services, and such other services the Company may reasonably request with respect to the business.

The Company agrees to reimburse WCL at cost for services and facilities provided by WCL. The charge to the Company for such services shall include all direct and indirectly allocable expenses. The agreement can be terminated by either party by giving sixty days prior written notice to the other party.

Conflicts of Interest

The Company has adopted and established a procedure for disclosure to its Board of Directors, of any material interest or affiliation on the part of any of its officers, directors, or responsible employees, which conflicts with or is likely to conflict with the person's official duties with the Company.

The conflict of interest statements filed by the directors, officers, and responsible employees during the period covered by this examination were reviewed. No conflicts were reported.

CORPORATE RECORDS

The Articles of Incorporation and By-Laws, as amended, were inspected during the course of the examination and appeared to provide for the operation of the Company in accordance with usual corporate practice and applicable statutes and regulations. The Articles of Incorporation were amended and restated on July 20, 1998. On November 2, 1998, the Articles of Incorporation were amended in order to change the name of the Company. The By-Laws of the Company were amended and restated with an effective date of August 1, 2000. One of the changes noted was the Board committees will consist of two or more directors of the Company rather than the previous requirement of three or more directors.

Minutes of meetings of the Stockholder, Board of Directors, and Executive Committee were reviewed for the period under examination. The minutes reflected approval of the investment transactions occurring during the examination period. The Company amended its Investment Guidelines on March 19, 2003. The amended Investment Guidelines were not approved by the Board of Directors. ALA CODE § 27-41-5 (1975) states that "An insurer shall not make any investment or loan, other than loans on policies or annuity contracts, unless the same be authorized, approved or ratified by the board of directors of the insurer..." Other than the aforesaid omission, the minutes appeared to be complete with regard to recording actions taken on matters before the respective bodies for deliberation and action.

HOLDING COMPANY AND AFFILIATE MATTERS

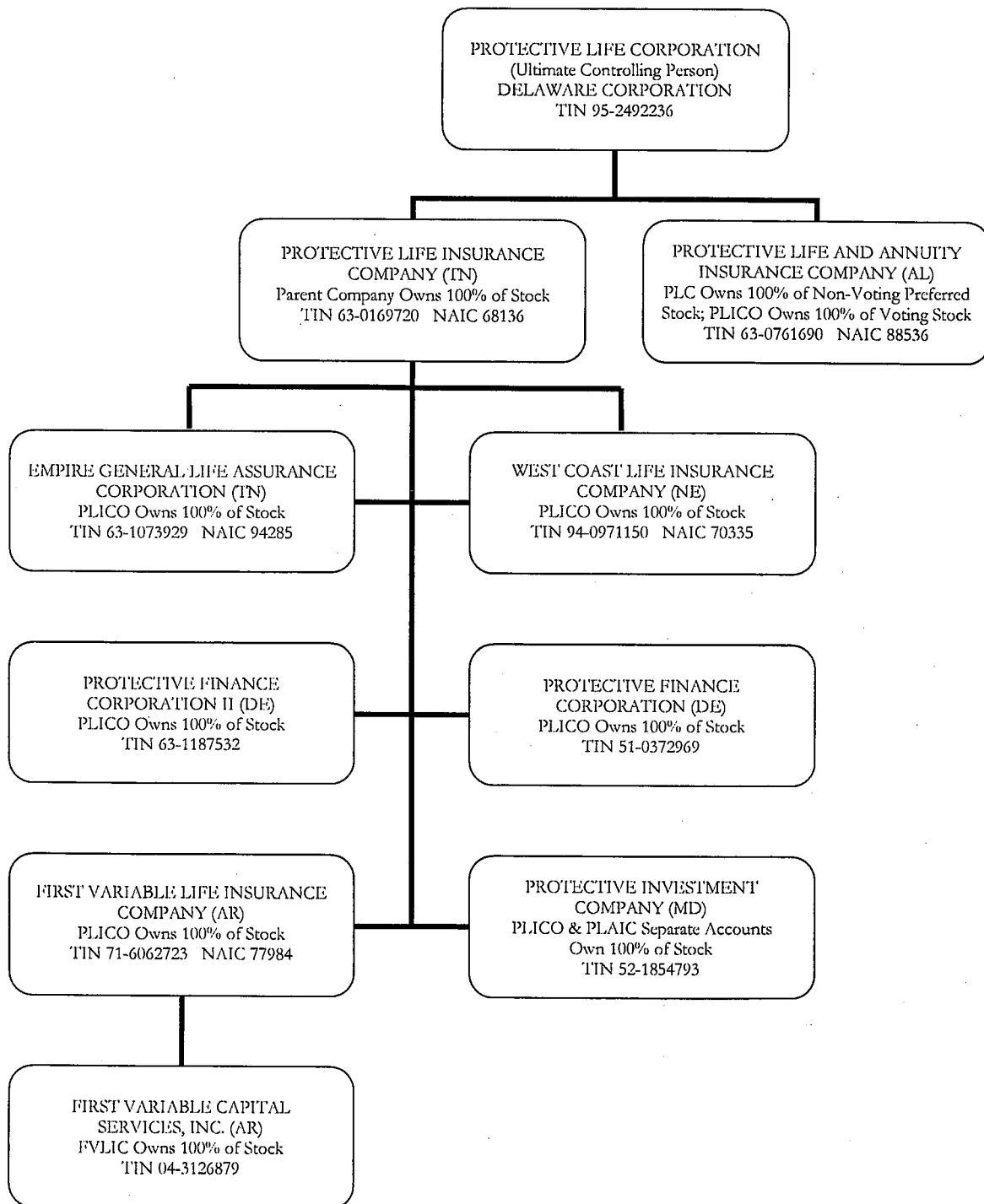
Holding Company

The Company is subject to the Alabama Insurance Holding Company Regulatory Act as defined in ALA. CODE § 27-29-1 (1975), as amended. Appropriate filings required under the Holding Company Act are made from time to time on behalf of the Company by Protective Life Corporation. A review of the filings during the period under review indicated that appropriate disclosures were included regarding the Company.

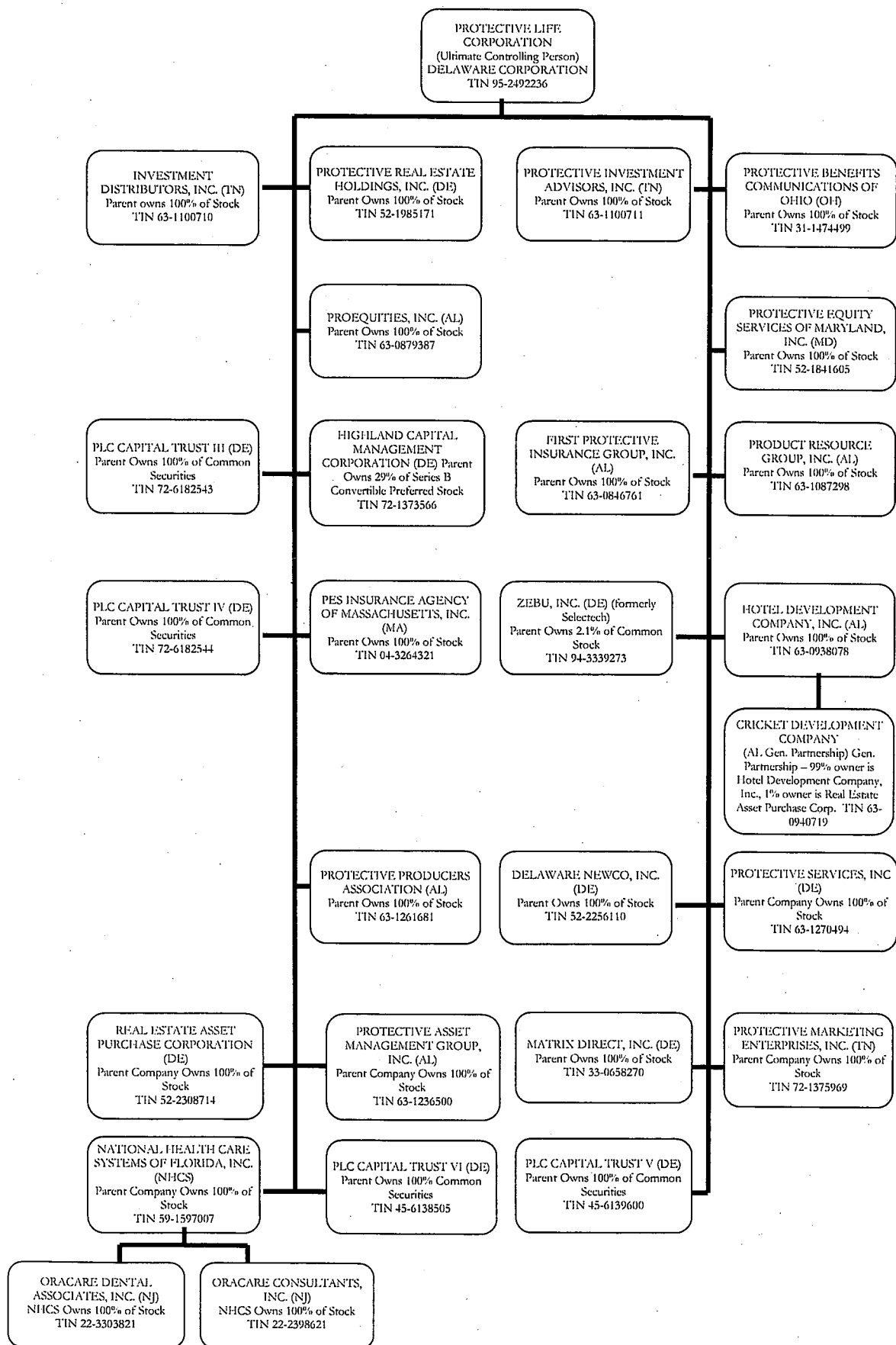
Organizational Chart

The following presents the identities of and interrelationships among all affiliated persons within the Insurance Holding Company System at December 31, 2003.

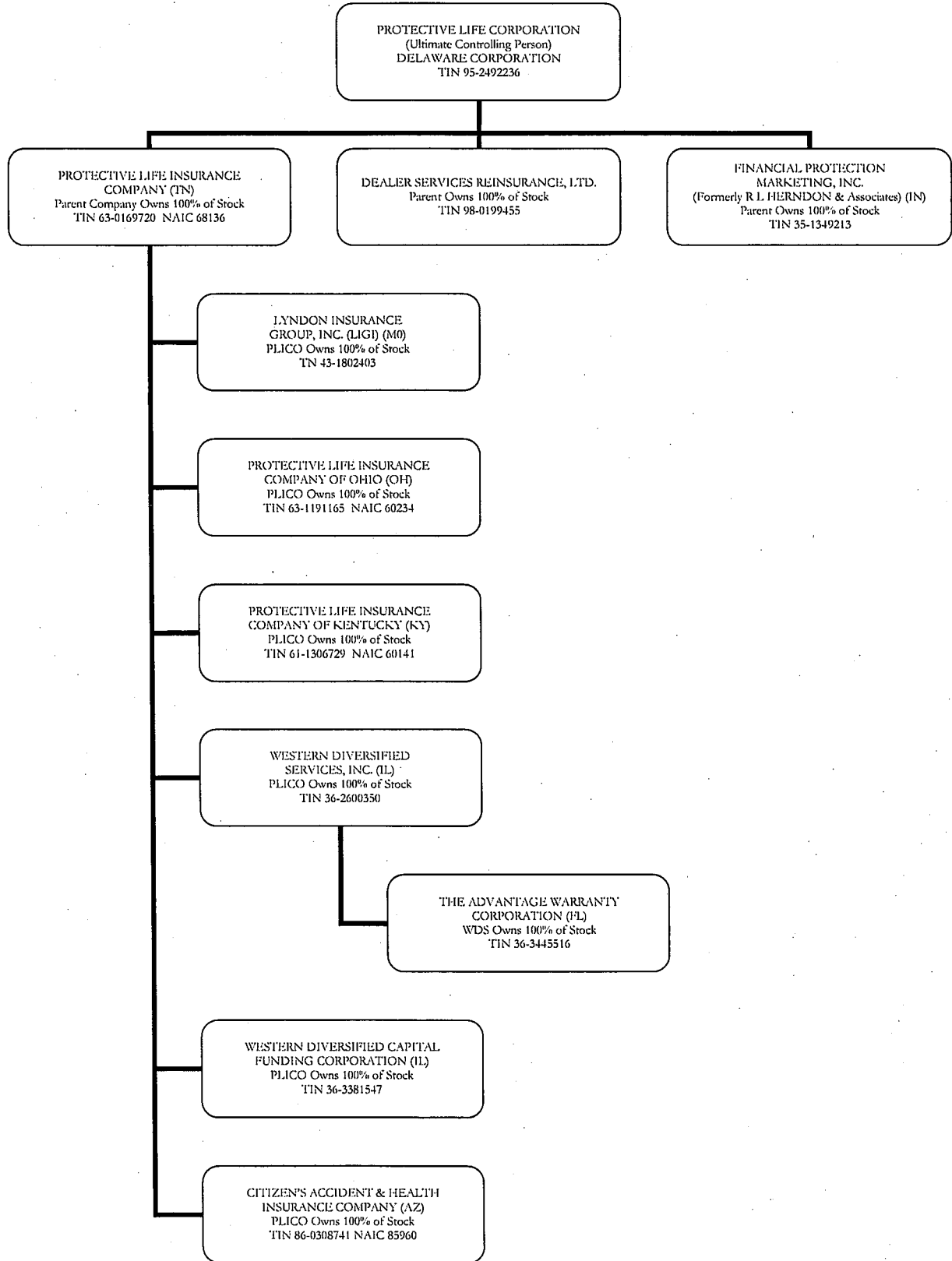
Protective Life Corporation Organizational Chart
As of December 31, 2003
PLICO Insurance Subsidiaries (excluding APD)



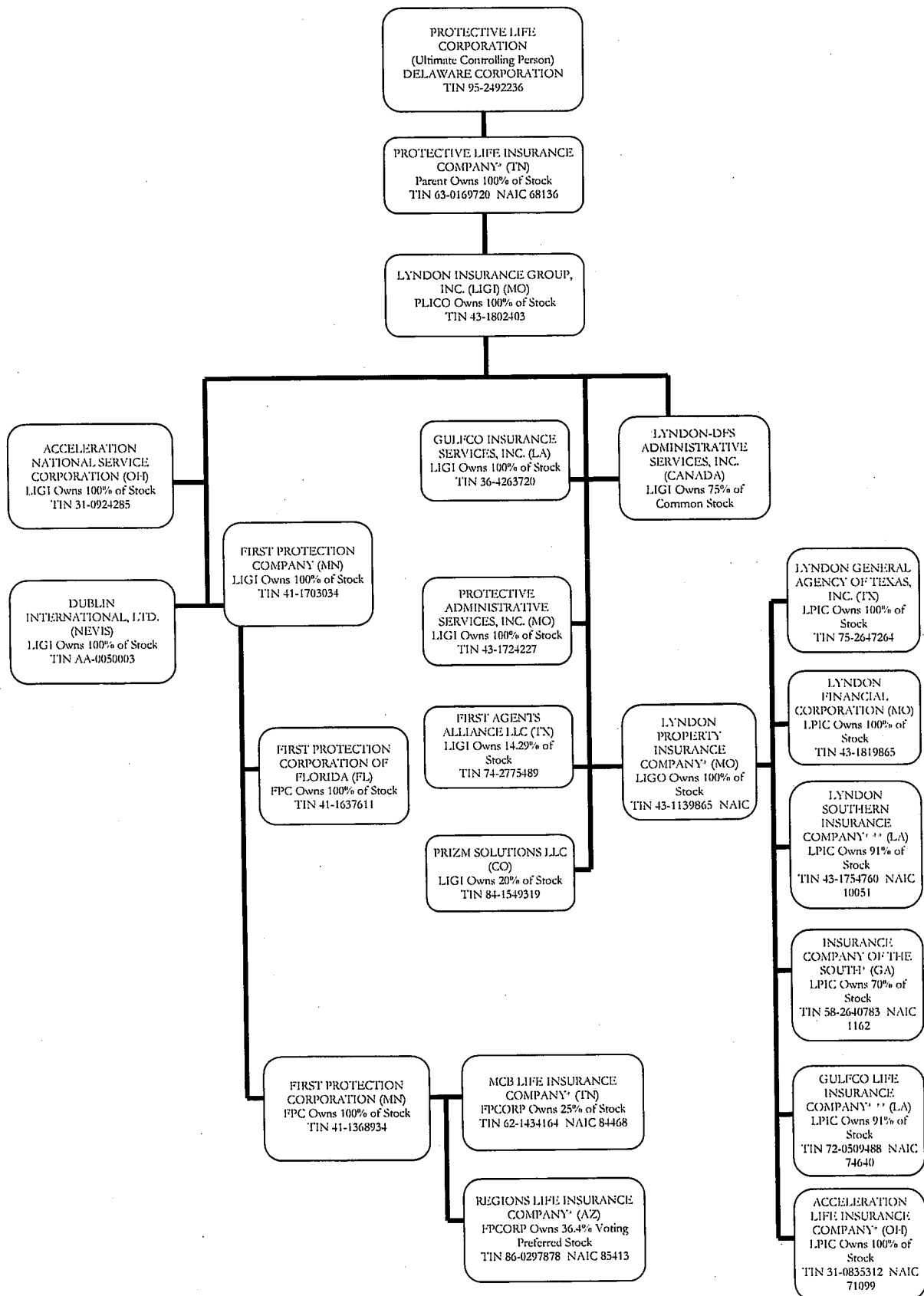
Protective Life Corporation Organizational Chart
As of December 31, 2003
PLC Non-Insurance Companies (excluding APD)



Protective Life Corporation Organizational Chart
As of December 31, 2003
Asset Protection Division



Protective Life Corporation Organizational Chart
As of December 31, 2003
Asset Protection Division



* Denotes insurance company

** Pursuant to Louisiana Insurance Code 22:81(2) each director of a domestic insurer must own at least 10 shares

Dividends to stockholders

The following aggregate dividends to stockholders were paid during the examination period. The amounts were confirmed through review of stockholder minutes.

<u>Year</u>	<u>Amount</u>
2000	\$12,750,000
2001	\$12,900,000
2002	\$14,750,000
2003	\$12,050,000

The Company declared a dividend to stockholder on November 12, 2001. Notification of the dividend was not sent to the Alabama Department of Insurance until November 27, 2001. ALA. CODE § 27-29-5(g)(2) (1975) states, "A domestic insurer subject to registration under section 27-29-4 shall report to the commissioner all dividends to shareholders within five business days following the declaration of the dividends and not less than 10 days prior to the payment of the dividends."

Exhibit A, Section 4.3(c) of the amendment to the Company's 1998 amended and restated Articles of Incorporation states:

The Board of Directors, when and as they shall deem advisable, without any action by the shareholders, may declare a cash dividend on the preferred stock of the Corporation at any time, to be payable at any time. There is no requirement that dividends, either cash or stock, be declared and/or paid out at any specific time, other than those as declared by the Board of Directors.

The Company paid one preferred stock dividend during the examination period. The preferred stock dividend was \$1,650,000, paid on December 31, 2002.

DIVIDENDS TO POLICYHOLDERS

The following schedule reflects the dividends paid to policyholders during the four-year examination period.

<u>Year</u>	<u>Amount</u>
2000	\$114,285
2001	\$106,090
2002	\$104,617
2003	\$ 98,919

FIDELITY BOND AND OTHER INSURANCE

At December 31, 2003, the Company was a named insured under a financial institution bond issued by Federal Insurance Company. The fidelity bond exceeded the NAIC Financial Condition Examiners Handbook suggested minimum amount. In addition to the above coverage, the Company also had insurance coverage for the following:

- Property Insurance (Building and Personal Property)
- Commercial General Liability
- Producers/Comprehensive Operations Liability
- Umbrella Excess Liability
- Automobile Liability
- Workers Compensation and Employers Liability
- Employment Practices Liability
- Fiduciary Liability
- Excess Fiduciary Liability
- Directors & Officers Liability
- Excess Directors & Officers
- Insurance Company Errors and Omissions
- Excess Professional Errors and Omissions
- Miscellaneous Professional Liability

EMPLOYEE AND AGENT WELFARE

The Company did not have any employees at December 31, 2003; therefore, it had no employee benefit plans. All functions of the Company were performed by employees of Protective Life Insurance Company, Empire General Life Assurance Corporation, and West Coast Life Insurance Company via administrative services agreements. Further comment on these contracts is included in this report under the caption "Management and Service Agreements."

STATUTORY DEPOSITS

At December 31, 2003, as required or permitted by law, the Company maintained deposits with the respective statutory authorities as follows:

<u>State</u>	<u>Par Value</u>	<u>Statement Value</u>	<u>Market Value</u>
Alabama (1)	\$1,550,000	\$1,664,385	\$1,744,825
Arkansas	4,200,000	4,740,553	4,757,802
Georgia	100,000	99,720	111,906
Massachusetts	500,000	502,346	518,905
New Mexico	250,000	269,025	281,828
North Carolina	400,000	428,877	442,024
TOTALS	<u>\$7,000,000</u>	<u>\$7,704,906</u>	<u>\$7,857,290</u>

(1) Held for the protection of all policyholders.

FINANCIAL CONDITION/GROWTH OF THE COMPANY

The following table sets forth the significant items indicating the growth and financial condition of the Company for the period under review:

	1999*	2000	2001	2002	2003*
Admitted Assets	\$490,177,226	\$518,045,942	\$539,582,566	\$724,399,310	\$705,607,456
Liabilities	458,030,719	486,167,780	505,228,546	621,848,761	604,623,771
Common Capital Stock	2,500,000	2,500,000	2,500,000	2,500,000	2,500,000
Preferred Capital Stock	2,000	2,000	2,000	2,000	2,000
Paid in and Contributed Surplus	106,725,865	106,725,865	106,725,865	176,725,865	176,725,865
Special surplus funds	41,731	26,975	16,047	9,492	6,815
Rounding					-3
Unassigned funds	\$-77,123,089	\$-77,376,678	\$-74,889,891	\$-76,686,808	\$-78,250,992

* Per Examination

MARKET CONDUCT ACTIVITIES

Plan of Operation

The Company's lines of business include credit life, credit disability, universal life (single life & survivor), term life (individual), variable annuities, market value adjusted annuities, single premium individual annuities, and acquisitions of blocks of business.

The Company marketed and sold variable annuities, market value adjusted annuities, and single premium individual type annuity contracts in the State of New York through licensed broker/dealers. The Protective variable annuity product offered a choice of 23 sub accounts managed by five investment managers including: Goldman Sachs Asset Management, Lord, Abbett & Co., MFS Investment Management, Oppenheimer Funds, Inc., and Van Kampen Asset Management, Inc. The Company's variable annuities were designed for investors who desired to accumulate capital on a tax deferred basis for retirement or other long-term investment purposes. The fixed accounts were guaranteed at the credited interest rate and did not have any guarantees other than a guaranteed minimum death benefit. The Platinum Series Annuity and Classic Series Annuity products offered market adjusted rates of interest for guaranteed periods ranging from three to ten years. The single premium immediate annuity product offered guaranteed immediate income payments with several payout options. The Company's immediate annuities were for investors who wanted regular income payments beginning immediately or in the future. Immediate annuities provided a stream of income payments from the insurance company to the owner beginning within twelve months of the purchase of the contract. These payments were guaranteed for life or for a specified period of time.

The Company marketed its products through four divisions, Institutional Distribution Group (IDG), West Coast Life Insurance Company (WCL), Empire General Life Assurance Corporation (EG), and Asset Protection Division (APD), a division of Protective Life Insurance Company (PLIC). The IDG is a part of the Life and Annuity Division of PLIC. Each division marketed and sold its products in New York. WCL marketed term and Universal Life products through its existing brokerage general agents (BGAs). The Company has plans to expand its production within New York based upon appointments of new BGAs who are domiciled in the state. The Company anticipates being able to offer opportunities for new business to the non-New York domiciled BGAs. IDG marketed term, Universal Life, and

fixed annuity products in New York primarily through Broker/Dealers. EG marketed a Simplified Issue Term Program (InstaTerm) in New York through BGAs to customers of banks, credit unions and savings and loan associations. This program offered 10, 15 and 20 year guaranteed level term insurance, delivered through an on-line program Internet Quick Issue (IQI) and properly licensed and appointed life insurance representatives. Based upon the responses to the questions contained in the IQI, the customer was either accepted or rejected. This division did not allow replacement of policies; however, a non-par whole life product was available for conversions from the term business. APD marketed and sold a small amount of group credit life/disability business in the state of New York. The policies were sold through automobile dealers to retail customers who were purchasing a new or used motor vehicle. The relationship with the automobile dealer was managed by either general agents or by direct sales employees. General agents managed 97% of the business and 3% of the business was managed by direct sales employees. The credit life coverage was sold at prima facie rates as set forth in New York law. The credit disability coverage was also sold at prima facie rates and was provided as either 14 day or 30-day retroactive coverage.

Territory

As of December 31, 2003, the Company was licensed to write business in the following states: Alabama, Arizona, Arkansas, California, Colorado, District of Columbia, Florida, Georgia, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Massachusetts, Michigan, Mississippi, Missouri, Nebraska, Nevada, New York, New Mexico, North Carolina, Ohio, Oklahoma, Oregon, South Carolina, Tennessee, Texas, Utah, Virginia, and Washington.

The certificates of authority were inspected for the period under review.

Policy Forms and Underwriting

The Company offered credit life insurance, credit disability insurance, term life, universal life, and market value adjusted and variable annuities. The examiners requested and obtained all policy form filings from the Company. The policy form filings filed with the Alabama Department of Insurance were for new policy forms only. There were no changes to any existing policy forms. The State of New York received and approved the majority of the policy forms filed during the period covered by this examination. During the examination period, the Company did not file its rates in New York, where its products are marketed and sold, because the State of New York does not exercise rate

jurisdiction. Alabama rates must be filed for approval; however, the Company did not sell or market any of its products in Alabama. Therefore, the Company did not file any of its rates.

In the underwriting of term and universal life insurance, the Company relied on information from several sources such as: motor vehicle reports, medical examinations, blood profile, attending physician statements, and data provided by the policy application. Based on the information assembled, the Company determined whether an application for insurance would be accepted or not accepted.

Advertising and Marketing

The Company marketed its products through four divisions. The four divisions were Institutional Distribution Group (IDG), Empire General Life Assurance Corporation (EG), West Coast Life Insurance Company (WCL), and Asset Protection Division (APD) of Protective Life Insurance Company (PLIC). The IDG is a part of the Life and Annuity Division of PLIC. Further discussion of the Company's distribution system is included in this report under the caption "Plan of Operation."

The types of products marketed were credit life insurance, credit disability insurance, term life, universal life, and market value adjusted and variable annuities. The Company's products were marketed using several forms of written sales literature, brochures, prospectuses, and through its web page. The web-based annuity advertisements were consistent with the printed advertisement materials. The Company filed certificates of compliance for all years under examination stating that the advertisements, which were disseminated by or on behalf of the insurer during the statement year, complied or were made to comply in all respects with the provisions of the statutes of the State of Alabama.

The website, [http:// www.3dquotes.com](http://www.3dquotes.com), that quotes the Company's products, was discovered during the examination as not correctly identifying the Company's name. The Company was identified as "Protective Life Insurance Company of New York." The website had an option that a prospect could choose to specifically apply for a policy, and the name of the Company is stated incorrectly there, as well as on the on-line application. According to Alabama Insurance Department Regulation No. 69 § IV(2),

Every insurer shall establish and at all times maintain a system of control over the method of dissemination, content, and form of all advertisements of its policies. All such advertisements, regardless of by whom written, created, designed, or presented, shall be the responsibility of the insurer whose policies are so advertised.

Also, Alabama Insurance Department Regulation No. 69 Section V(6)(c) states

The name of the insurer shall be clearly identified on all of its advertisements. If any specific individual policy is advertised it shall be identified either by form number or other appropriate description. If an application is a part of the advertisement, the name of the insurer shall be known on the application.

Because the website incorrectly identified the name of the Company whose product it was advertising, the Company was not in compliance with the aforesaid regulation.

Claims Processing

The Company has three different processing centers for claims. Claims are processed at each of these offices in a similar manner. The three centers are Life of the South Service Company in Jacksonville, Florida, Protective LA in Los Angeles, California, and Protective Life Insurance Company's claim processing center in Brentwood, Tennessee.

During the course of the examination, the Company provided a copy of its permitted practice letter signed by the Alabama Commissioner of Insurance dated November 8, 2001. The permitted practice letter allowed the Company the privilege of maintaining certain source documents relating to pending claims in its claims office in Tennessee for the purpose of processing the claims and for a reasonable period of time after a claim was processed for the purpose of imaging the documents. The permission granted expired on December 31, 2004. Further discussion of the permitted practice is included in this report under the caption "SUBSEQUENT EVENTS."

The examination determined that the Company was not maintaining all claims records at its home office as required by ALA. CODE §27-27-29(a)(1975), which states, "Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs..." Claims information, for

claims that were being processed by Protective LA, Life of the South Services Company, and other third party administrators, was not maintained at the Company's home office.

Claims Review

Closed claim files reviewed during the examination indicated that claims were being paid in accordance with policy provisions and that settlements were made promptly upon receipt of proper evidence of the Company's liability. The Company resisted payment only in cases where there appeared to be justifiable cause for further investigation or denial.

The Company only included in its 2003 Schedule F denied claims that had a resisted status as of December 31, 2003. The NAIC Annual Statement Instructions require that all claims with a resisted status as of the year end and all resisted or compromised claims that were disposed of during the current year be reported in Schedule F.

Policyholder Complaints

The Company documented 38 complaints in its records for the exam period. These complaints were not exclusive to Alabama and included complaints from policyholders residing in the following states: Arkansas, South Carolina, New Jersey, New York, Pennsylvania, Florida, and Tennessee.

During the examination period, there were two complaints received by the Alabama Department of Insurance regarding the Company. The examiners reviewed all of the Company's complaint records for the examination period. The review indicated that policyholders' issues were addressed in a timely manner and the Company's responses properly addressed the issues raised by the complainants. The examiner determined that the Company maintained complete records of its complaint files in accordance with the recommended guidelines found in the NAIC Market Conduct Examiners Handbook, Appendix pages A-16-17.

Compliance with Agents' Licensing Requirements

A review of Company records was performed to determine that agents representing the Company in Alabama were appropriately licensed. It was determined that no first year premiums were written in the state of Alabama

during the period covered by this examination; therefore, no exceptions were noted with the agents' licensing requirements of the State of Alabama.

Privacy Standards

The Company does not share customer and/or consumer personal information with any nonaffiliated third parties except those permitted under Sections 14, 15, and 16 of ALA. ADMIN. CODE 482-1-122. The Company had adequate controls in place for employees and producers that handled personal information.

The Company provided notices to its customers that indicated the types of information collected, the way it was used, and the manner in which it was collected. The notice also informed the customers that the Company did not disclose any information to any nonaffiliated third parties.

The Company's disclosure of any health information was made only after authorization was obtained from its customers unless the disclosures were made under Section 17B of the NAIC model regulation.

REINSURANCE

The Company assumed and ceded reinsurance under a number of agreements at December 31, 2003. The examination of the various contracts was limited to the contracts with material reserve balances assumed and ceded. The contracts were examined with regard to the type of contract, reinsurance credits, and pertinent safeguards. The Company combined all treaties of a particular reinsurance type into a single line in its 2003 Schedule S and used the earliest treaty date. This presentation was not in accordance with the NAIC Annual Statement Instructions, which requires that each treaty be presented on a different line within Schedule S with the contract's original effective date. The following commentary presents a summary of the Company's reinsurance program.

Reinsurance Assumed

The Company assumed life and accident and health business from ten insurance companies at December 31, 2003. One contract had an effective date during the period covered by this examination. As reflected in Schedule S of the 2003 Annual Statement, the Company assumed:

Life reserves of \$440,310,597 and paid and unpaid losses of \$6,168,594 relating to life contracts;

and, unearned premiums of \$18,174,592, additional reserves of \$7,319,967, and paid and unpaid losses of \$1,665,450 under the accident and health contracts.

Treaties with reserves comprising at least 88.60 percent of the total assumed reserves were selected for review, which resulted in treaties with four companies. These treaties are discussed below:

Retrocession Agreement between Lincoln National Life Insurance Company (Lincoln) and American Foundation Life Insurance Company (the Company) as of October 1, 1998

Lincoln retroceded to the Company on a one hundred percent coinsurance basis the liabilities assumed by Lincoln under two coinsurance agreements. This agreement does not reinsure any policy written by Lincoln after the effective date of the contract. In addition, the Company will provide policyholder service for the policies, supply Lincoln copies of accounting and other records pertaining to such services, and provide copies of all actuarial reserve opinions, memoranda, and evaluations pertaining to the reserves. The contract shall remain in force until such time as the Company's liability with respect to the policies reinsured is terminated. The life reserves assumed under these policies at year-end 2003 had an aggregate amount of \$356,542,490.

Retrocession Agreement between Lincoln Life and Annuity Company of New York (Lincoln NY) and American Foundation Life Insurance Company (the Company) as of October 1, 1998

Lincoln NY retroceded to the Company, on a one hundred percent coinsurance basis, the liabilities assumed by Lincoln NY under two coinsurance agreements. This agreement does not reinsure any policy written by Lincoln NY after the effective date of the contract. In addition, the Company will provide policyholder service for the policies, supply Lincoln NY copies of accounting and other records pertaining to such services, and provide copies of all actuarial reserves opinions, memoranda, and evaluations pertaining to the reserves.

This contract shall remain in force until such time as the Company's liability with respect to the policies reinsured is terminated. The life reserves assumed under these policies at year-end 2003 had an aggregate amount of \$52,844,570.

Indemnity Coinsurance Agreement between First Unum Life Insurance Company (First Unum), Protective Life Insurance Company (PLIC) and American Foundation Life Insurance Company (the Company) as of December 31, 1995

First Unum originally ceded to PLIC on a one hundred percent basis a block of universal life insurance as of July 1, 1993. Effective December 31, 1995, the Company entered an agreement with First Unum and PLIC to assume and to perform all of PLIC's duties under the Indemnity Coinsurance Agreement. The Company will provide all normal and necessary policyholders' service, supply First Unum copies of accounting and other records pertaining to such service, and calculate and provide First Unum a monthly accounting.

This contract shall remain in force until such time as the Company's liability with respect to the policies reinsured is terminated. The life reserves assumed under these policies at year-end 2003 had an aggregate amount of \$9,334,893.

Amended Coinsurance Agreement between XL Life Insurance and Annuity Company (XL Life) and Protective Life Insurance Company (PLIC) naming Protective Life and Annuity Insurance Company (the Company) as the Successor Reinsurer effective November 30, 2002

XL Life and PLIC entered into a coinsurance agreement dated as of October 8, 2001, whereby PLIC was to reinsure one hundred percent of a block of credit life and accident and health business. On December 30, 2002, a novation was done amending the coinsurance agreement between XL Life and PLIC, and naming the Company as the successor reinsurer effective November 30, 2002. The Company then retroceded this block of business one hundred percent on a funds withheld basis to PLIC also effective November 30, 2002.

PLIC shall prepare accounting for premiums, commissions, expense allowances, tax allowances, claims, refunds, and cancellations, shall provide all administrative services with respect to the coinsured policies, and shall supply to the Company and XL Life all information and data required to enable the Company and XL Life to prepare quarterly and annual financial statements filed with insurance regulatory authorities; furnish financial information necessary to satisfy the financial reporting obligations under federal security

laws of XL Life's affiliates; furnish financial information as may be necessary to comply with any requests by Governmental Entities; and provide such information as may be necessary to comply with any other requests that have a contractual basis from third parties; provided, however, PLIC shall cooperate in furnishing any such information and data to any other third parties as may be reasonably requested by either the Company or XL Life.

These agreements shall remain in force until the last coinsured policy ceases to be in force and all liabilities and obligations under these agreements have been extinguished. The year-end 2003 reserves and liabilities assumed and then retroceded under these agreements were as follows:

Life reserves of \$17,775,984 and reinsurance payable on paid and unpaid losses of \$714,862;

and, accident and health unearned premiums of \$18,157,024, reserve liability other than for unearned premiums of \$6,488,072, and reinsurance payable on paid and unpaid losses of \$1,655,981. The Company received money from PLIC under a funds withheld arrangement equal to the liabilities listed above at December 31, 2003.

Reinsurance Ceded

The Company ceded life and accident and health business to nineteen insurance companies at December 31, 2003. As reflected in Schedule S of the 2003 Annual Statement, the Company took reserve credits as follows:

Life reserve credits of \$43,332,807;

and, unearned premium credits of \$18,205,139 and additional reserve credits of \$7,485,470 under the accident and health contracts.

Treaties with reserves comprising at least 86.70 percent of the total assumed reserves were selected for review, which resulted in treaties with four companies. These treaties are discussed below:

Retrocession Agreement between Protective Life Insurance Company (PLIC) and the Company effective November 30, 2002

For a synopsis of this agreement, see "Amended Coinsurance Agreement between XL Life Insurance and Annuity Company (XL Life) and Protective

Life Insurance Company (PLIC) naming Protective Life and Annuity Insurance Company (the Company) as the Successor Reinsurer effective November 30, 2002" under the "Reinsurance Assumed" caption of this report.

Automatic Yearly Renewable Term Agreement between RGA Reinsurance Company (RGA) and the Company effective October 1, 1998

The Company entered into an automatic reinsurance agreement with RGA effective October 1, 1998. RGA automatically accepted reinsurance if the following conditions were met: 1) the Company retained 10% of each in force net amount at risk ceded (face amount less the cash value); 2) the risk was issued before July 1, 1999; 3) life policies were in force as of October 1, 1998, and new business through July 1, 1999, issued on Aetna policy forms on Aetna sponsored business acquired from Lincoln National Life Insurance Company and Lincoln Life and Annuity Insurance Company; and 4) the risks were residents of the United States, Canada, Puerto Rico, or Guam. Claims payments will be based on the same net amount at risk as the premium payment calculation.

Premiums for life reinsurance and reinsurance of supplemental benefits will be based on agreed upon mortality tables and will be paid annually in advance. The life reinsurance rates contained in the agreement are guaranteed for twenty years, and RGA anticipates continuing to accept premiums on the basis of these rates indefinitely. If RGA deems it necessary to increase rates, such increased rates cannot be higher than 250% of the attained age rate from the appropriate 1980 Commissioners Standard Ordinary mortality table (1980 CSO).

The Company furnishes monthly statements and payments to RGA within thirty days following the close of each month for the net amount due RGA. At December 31, 2003, a life reserve credit taken for this business was \$9,852,660.

Automatic Modified Coinsurance Agreement between North American Reassurance Company (now Swiss Re America) (NARC) and the Company effective June 5, 1984

The Company entered into a coinsurance agreement with NARC effective June 5, 1984, to cede amounts of individual life and waiver of premium disability insurance on standard and substandard lives whose surnames are spelled commencing with any letter from M to R inclusive on the RLR, T-100, and ART plans. The agreement shall be unlimited as to its duration but may be

cancelled at any time, insofar as it pertains to the handling of new business thereafter, by either party giving ninety days written notice of cancellation.

The Company shall pay premiums to NARC on an annual basis corresponding to the premiums charged the insured. Effective January 1, 1986, the Company's retention is as follows:

Life

<u>Ages</u>	<u>Standard – Table 4</u>	<u>Table 5 – 8</u>	<u>Table 10 - 16</u>
0 – 60	\$150,000	\$75,000	\$37,500
61-70	\$ 75,000	\$37,500	\$15,000
71 and above	None	None	None

ADB

Reinsured on a Bulk Basis

Waiver of Premium

Issue Ages:	All
Standard - Table 4:	\$1,000,000 (On facultative cases, waiver of premium retention will equal life retention)
Table 5 - 8:	Not applicable
Table 10 -16:	Not applicable

The coinsurance limit is five million dollars per life.

The reserve credit taken for this business at December 31, 2003, was \$1,970,432.

Automatic and Facultative Coinsurance Agreement between Security Life of Denver Insurance Company (otherwise known as -ING Reinsurance) and the Company effective June 1, 2002 and Automatic and Facultative Coinsurance Agreement between Swiss Re Life and Health America, Inc. (SwissRe) and the Company effective June 1, 2002

The Company entered into coinsurance agreements with ING Reinsurance and SwissRe, effective June 1, 2002, to reinsure New York level term insurance business for ten, fifteen, and twenty year periods. ENK61 - ENK75 are the

plans covered. The Company retains ten percent with the rest going to a pool, whereby ING Reinsurance and SwissRe each take fifty percent of the pool and forty-five percent of the face amount of each policy. Amendment one to the agreement added plan codes ENK92 - 94 effective for policies issued on September 1, 2002, and after with no change in either party's retention. Amendment two to the agreement added plan codes ENK21 - 32 on New York term twenty-five to thirty year plans effective for policies issued on March 1, 2003, and after. The Company's retention is ten percent on ten, fifteen, twenty, and twenty-five year plans and five percent on thirty year plans in the ING Reinsurance treaty; however, for the thirty year plan in the SwissRe treaty, the Company's retention was ten percent. This inconsistency was determined to be immaterial. Amendment three to the agreement added plan codes ENL73 - ENL97 on New York term ten through thirty year plans effective on policies issued on October 1, 2003, and after. The Company's retention was five percent for these added plans with the remaining going to the pool, whereby ING Reinsurance covers seventy percent and SwissRe covers the remaining thirty percent of this pool.

Premiums on this business are paid annually in advance on the policy issue date and each subsequent policy anniversary date. The premium allowance on this business is one hundred percent for the first year and between 12% and 21.50%, based on the plan, for the renewal years. The Company is to provide a monthly statement including information on the risks reinsured with ING Reinsurance and SwissRe, premiums owed, policy exhibit activity, and an accounting summary. Within fifteen days after the end of each calendar quarter, the Company will submit a reserve credit summary to each reinsurer.

At December 31, 2003, reserve credits taken for the business ceded to ING Reinsurance was \$945,447 and \$1,161,556 for business ceded to SwissRe. See "Note 6- Aggregate reserve for life contracts" on page 49 for commentary on the disallowance of these reserve credits.

Coinsurance Agreement between The Lincoln National Life Insurance Company (now Swiss Re Life & Health America, Inc. [SwissRe]) and the Company effective September 1, 2001

The Company entered into a coinsurance agreement with SwissRe, effective September 1, 2001, to reinsure level term business written by West Coast Life Insurance Company, a Company affiliate. The plan codes covered by this agreement were Empire 10, 15, and 20 (first two versions). The Company is to

retain ten percent of each policy amount not to exceed the retention limits below:

<u>Ages</u>	<u>Standard - Table D</u>	<u>Tables E - H</u>	<u>Tables I - P</u>
0-75	\$250,000	\$250,000	\$125,000
76-80	125,000	125,000	75,000
81-85	125,000	125,000	75,000
86-90	75,000	-0-	-0-

The remaining ninety percent is split between SwissRe, which retains eighty-five percent, and ERC Life Reinsurance Corporation which takes the remaining five percent. The Company is to provide within thirty days of each month: a billing statement containing policy level detail; a summary accounting report summarizing all financial transactions during the reporting period; and a policy exhibit report indicating in force reinsurance as of the beginning of the reporting period, increases and decreases during the reporting period, and the resulting in force at the end of the period. Within ten days following each quarter-end, the Company is to provide a reserve report to SwissRe. Premiums are payable annually in advance.

At December 31, 2003, the Company took a reserve credit of \$5,009,977 in relation to this agreement. See "Note 6- Aggregate reserve for life contracts" on page 49 for commentary on the disallowance of this reserve credit.

Automatic and Facultative Coinsurance Agreement between Security Life of Denver Insurance Company (otherwise known as -ING Reinsurance) effective September 3, 2002

The Company entered into a coinsurance agreement with ING Reinsurance effective September 3, 2002, to reinsure level term insurance business written by West Coast Life Insurance Company, a Company affiliate. The business covered by this agreement is as follows: Empire 10, 15, and 20 plans, version 4. The Company's retention is ten percent up to maximum retention with the rest going to a pool, whereby ING Reinsurance takes fifty percent of the pool. Amendment one to the agreement was done on January 1, 2003, to add plans Empire 25 and Empire 30, both version 1. The Company's retention is ten percent on these additional plans to maximum retention with the exception of Empire 30 plan, where the Company's retention is five percent. ING

Reinsurance takes fifty percent of the pool for this additional business. Amendment two to the agreement was done on September 1, 2003, to add B4 series of plans Empire 10, 15, 20, 25, and 30. The Company's retention is ten percent on these additional amendment two plans to maximum retention with the exception of the B4 series and the Empire 30 plan, where it is five percent. ING Reinsurance takes seventy percent of the pool on the B4 series and fifty percent of the pool on the rest of these additional plans. Swiss Re Life and Health America, Inc. and ERC Life Reinsurance Corporation are the other two participants (reinsurers) in the pool.

Premiums on this business are paid annually in advance on the policy issue date and each subsequent policy anniversary. The premium allowance on this business is one hundred percent for the first year and between sixteen and twenty-two percent based on the plan for the renewal years. The Company is to provide a monthly statement including information on the risks reinsured with ING Reinsurance, premiums owed, policy exhibit activity, and an accounting summary. Within fifteen days after the end of each calendar quarter, the Company will submit a reserve credit summary to the reinsurer. At December 31, 2003, the reserve credit taken on this business was \$4,182,832.

Automatic Self Administered Individual Coinsurance Reinsurance Agreement between Swiss Re Life & Health America Inc. (SwissRe) and the Company effective January 1, 2003

The Company entered into a coinsurance agreement with SwissRe effective January 1, 2003, to reinsure level term insurance business written by West Coast Life Insurance Company, a Company affiliate. The plans covered are Empire 25/25 and Empire 30/30. Policies issued after September 30, 2003, were not eligible for reinsurance coverage. The Company's retention is ten percent on the Empire 25/25 plan and is five percent on the Empire 30/30 plan not to exceed a maximum retention of \$250,000, whereby the remaining ninety percent of Empire 25/25 and the remaining ninety-five percent of Empire 30/30 goes to the pool. SwissRe reinsures 40.50% of the face amount of the Empire 25/25 plan and 42.75% of the face amount of the Empire 30/30 plan, which is forty-five percent of the pool. ING Reinsurance and ERC Life Reinsurance Corporation are the other two reinsurers in the pool taking 50% and 5%, respectively, of the pool.

The Company will pay SwissRe a basic premium calculated by multiplying the net amount at risk of the reinsured policy by the appropriate rate from the set

of rates included within the reinsurance contract. Premiums on this business are paid on a policy year basis in advance, regardless of the premium payment mode under the original insurance. The reinsurance allowance on this business is one hundred percent for the first year and nineteen percent for the renewal years. The Company is to send SwissRe, electronically, a monthly new and renewal business report, a monthly changes and terminations report, a quarterly inforce report, a monthly accounting report, a quarterly statutory reserve report, a monthly policy exhibit report, an annual valuation reserve certification, and an annual tax reserve certification.

At December 31, 2003, the reserve credit taken for this business was \$637,649. See "Note 6 - Aggregate reserve for life contracts" on page 49 for commentary on the disallowance of this reserve credit.

Automatic Self Administered Individual Coinsurance Reinsurance Agreement between Swiss Re Life & Health America Inc. (SwissRe) and the Company effective October 1, 2003

The Company entered into a coinsurance agreement with SwissRe, effective October 1, 2003, to reinsure level term insurance business written by West Coast Life Insurance Company, a Company affiliate. The plans covered by this agreement are B4 series Empire 10, 15, 20, 25, and 30 plans. The earliest policy date this agreement covers is April 1, 2003, with policies not covered with issue dates after December 31, 2003. The Company retains five percent not to exceed \$250,000 with the remaining ninety-five percent going to a pool. Swiss Re takes thirty percent of the pool and 28.5 percent of the face amount with ING Reinsurance taking the remaining seventy percent and 66.5 percent of the face amount.

The Company will pay SwissRe a basic premium calculated by multiplying the net amount at risk of the reinsured policy by the appropriate rate from the set of rates included within the reinsurance contract. Premiums on this business are paid on a policy year basis in advance, regardless of the premium payment mode under the original insurance. The reinsurance allowance on this business is one hundred percent for the first year and between twelve percent and fifteen and one-half percent for the renewal years. The Company is to send SwissRe, electronically, a monthly new and renewal business report, a monthly changes and terminations report, a quarterly inforce report, a monthly accounting report, a quarterly statutory reserve report, a monthly policy exhibit report, an annual valuation reserve certification, and an annual tax reserve certification.

At December 31, 2003, no reserve credit was taken for this business.

ACCOUNTS AND RECORDS

The Company's principal accounting records were maintained by computer with certain detail subsidiary records maintained manually. Management and record-keeping functions were performed by personnel and facilities of the Protective Life Insurance Company (PLIC), Protective Life Corporation (PLC), Empire General Life Assurance Corporation, and West Coast Life Insurance Company under various management and service agreements. Further discussion on the aforesaid agreements is included in this report under the caption "Management and Service Agreements" elsewhere in this report.

Lack of Appropriate Reconciliation of Detail

The Company's general ledger contained the detail of all transactions occurring within the general ledger accounts; however, the system was unable to produce, for certain inter-company and suspense accounts, the outstanding detail that reconciled back to the running balance that was the sum of the debits and credits recorded in the general ledger. Company personnel, when requested by examiners, successfully reconciled (within immaterial amounts) all transactions contained in specific general ledger accounts back to the transactions outstanding at year-end; however, the Company should maintain, at least on a quarterly basis, a reconciliation of all general ledger accounts that ties back to the outstanding transactions recorded in its Quarterly and Annual Statements. ALA. CODE § 27-27-29(a) (1975) states, in part, that "Every domestic insurer... shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted."

Records maintained outside of the State of Alabama

During the course of the examination, the examiners obtained policy files and policy level detail of the reserves. The examiners noted that some of this information was not available from the Company's records maintained at its home office. The Company had to obtain the requested information from the Company's third party administrators and affiliates from remote locations in states outside of Alabama. The examiners noted that the Company maintained its letter of credit, which collateralized reinsurance reserve credits taken involving an unauthorized reinsurer, at a West Coast Life Insurance Company

office in San Francisco, California. ALA. CODE § 27-27-29(a)(1975) states, "Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs... ." ALA. CODE § 27-27-29(c), (1975) states that the

Removal of all, or a material part of, the records or assets of a domestic insurer from this state except pursuant to a plan of merger or consolidation approved by the commissioner under this title, or for such reasonable purposes and periods of time as may be approved by the commissioner in writing in advance of such removal, or concealment of such records or assets, or material part thereof, from the commissioner is prohibited.

The examination noted that the Company was not complying with the aforesaid statutes. Further discussion of the location of the Company's records is included in this report under the caption "Claims Processing."

Numerous Immaterial Errors

The examiners requested the detailed transactions that comprised 2003 Annual Statement accounts. The Company provided the detailed transactions that reconciled within immaterial variances to reported amounts, with the exception of the aforementioned inter-company and suspense accounts. However, there were numerous instances in which there were immaterial variances between the detailed transactions provided by the Company and the amounts reported in the 2003 Annual Statement and instances in which immaterial errors were discovered by the examiners. In addition to the examination findings noted under the caption "NOTES TO FINANCIAL STATEMENTS" elsewhere in this report, the examiners noted the following discrepancies and errors in the amounts reported in the 2003 Annual Statement:

The Company did not provide detail for \$86,524 of the gross reserves for life contracts. The amount of \$35,541 was explained to be due to booking lags and \$7,797 was explained to be due to a booking error. The Company did not provide detail for \$77,784 of the ceded reserves for life contracts. \$32,168 was explained to be due to booking lags and corrections. The Company did not provide an explanation for the remaining discrepancies.

The detail of the Company's policies in-force at December 31, 2003, did not reconcile with the Company's 2003 Exhibit of Life Insurance. The number of policies in-force from the detail was 327,666. The number of policies in-force from the 2003 Exhibit of Life Insurance was 327,718, which resulted in a variance of 52. The amount of insurance in-force from the detail was \$8,619,462,411. The amount of insurance in-force from the 2003 Exhibit of Life Insurance was \$8,596,106,000, which resulted in a variance of \$23,356,411. The Company provided unsupported adjustments to the detail that reconciled the amount of insurance from the detail to the amount of insurance from the Exhibit of Life Insurance within an immaterial variance of \$1,411. The unsupported adjustments were identified as expirations that were erroneously booked and blocks of business that were booked after year-end because the detail was received after the financial reporting date.

The Company did not provide policy level detail that reconciled to the Aggregate reserve for accident and health contracts line item. The details of \$335,020 of the gross reserves and \$306,628 of the ceded reserves were not provided.

The Company did not provide policy level detail that reconciled to the December 31, 2003 pending life claims. Detail in the amount of \$50,668 was not provided.

The Company did not provide policy level detail that reconciled to the December 31, 2003 pending accident and health claims. Detail in the amount of \$200,848 was not provided.

The Company failed to record the proper liability in its general ledger in relation to amounts due to reinsurers. The error resulted in an understatement of its Remittances and items not allocated line item by \$209,839.

The examiners determined that the Company understated its Premiums and annuity considerations for life and accident and health contracts received in advance line item by \$21,312. The discrepancy was determined to be due to a booking error on a certain block of business.

The Company incorrectly included \$140,000 in the reported Receivable for securities line item. The receivable was offset by an error in an offsetting liability account, which was reported in the Remittances and

items not allocated line item. The recognition of the offsetting liability resulted in no effect upon the Company's surplus.

The Company incorrectly calculated its commissions to agents due or accrued in relation to its accident and health business, which resulted in an overstatement in the Commissions to agents due or accrued line item of \$13,456.

The Company's general ledger contained an error in its accrued interest from mortgage loans. The error resulted in a \$29,854 understatement of the reported Investment income due and accrued line item.

The Company overstated its reported Other amounts receivable under reinsurance contracts line item by \$13,542. This overstatement amount was derived from the Company incorrectly including an amount in the ceded due premium commission calculation.

The detail of the Uncollected premiums and agents' balances in course of collection line item was \$22,941 less than the amount reported. The difference was due to a miscalculation of the reinsurance ceded detail.

The Company did not provide detail that reconciled to the reported Liability for deposit-type contracts line item. The Company did not provide \$1,172 of the detail.

In addition to the aforesaid discrepancies and errors noted in relation to the amounts reported in the 2003 Annual Statement, the following errors were noted by the examiners in relation to the 2000, 2001, and 2002 Annual Statements:

The Company did not include unrealized gains and losses on separate account investments in its Asset valuation reserve (AVR) calculation for the years 2000 - 2002. This resulted in an understatement of the AVR line item for the years 2000 - 2002. The full unrealized gain was recognized in the 2003 AVR calculation.

The Company incorrectly reported a liability comprised of agents' balances due by reporting it in the Other assets nonadmitted line item in its 2000 Annual Statement with a negative balance of \$(80,575). The entire negative amount was nonadmitted, which effectively removed the liability from the financial statements.

ALA. CODE § 27-27-29(a) (1975) states, in part, that "Every domestic insurer ...shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted." The examination noted that the Company did not keep complete records of its assets, transactions, and affairs.

Lack of Responsiveness to the Examiners Information Requests

There were numerous instances in which the Company officials and personnel did not respond to the examiners' information requests within ten business days as required by Alabama Insurance Department Regulation No. 118 § 6 which states:

The insurer shall provide, within ten (10) working days, any record or response requested in writing by any duly appointed deputy, assistant, employee or examiner of the commissioner. When the requested record or response is not produced or cannot be produced by the insurer within ten working days, the nonproduction shall be deemed a violation of this rule, unless the Commissioner or duly appointed person making the request grants an extension in writing or the insurer can demonstrate to the satisfaction of the Commissioner that there is a reasonable justification for the delay.

FINANCIAL STATEMENTS

The financial statements included in this report were prepared on the basis of the Company's records, and the valuations and determinations made during the examination for the year 2003. Amounts shown in the comparative statements for the years 2000, 2001, and 2002 were compiled from Company copies of filed Annual Statements. The statements are presented in the following order:

Statement of Assets, Liabilities, Surplus and Other Funds	Pages 43 and 44
Summary of Operations	Page 45
Capital and Surplus Account	Page 46

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART THEREOF.

Protective Life and Annuity Insurance Company
Statement of Assets, Liabilities, Surplus and Other Funds
For the Year Ended December 31, 2003

Assets

	Asset	Non- Admitted Asset	Admitted Asset
Bonds (Note 1)	\$ 546,149,373	\$	\$ 546,149,373
Mortgage loans on real estate	1,393,260		1,393,260
Cash and short-term investments (Note 2)	14,253,494		14,253,494
Contract loans	54,087,760	50,529	54,037,232
Receivable for securities	164,931		164,931
Investment income due and accrued	10,184,309		10,184,309
Uncollected premiums and agents' balances in course of collection (Note 3)	31,892	27,947	3,945
Deferred premiums, agents' balances and installments booked but deferred and not yet due	1,860,035		1,860,035
Amounts recoverable from reinsurers	4,619,430	543,070	4,076,360
Other amounts receivable under reinsurance contracts (Note 4)	314,475		314,475
Net deferred tax asset	4,845,699	1,710,445	3,135,254
Guaranty funds receivable or on deposit	8,366		8,366
Receivable from parent, subsidiaries and Affiliates	1,562		1,562
Healthcare and other amounts receivable	92,090	92,090	0
Aggregate write-ins for other than invested Assets	81,182		81,182
From Separate Accounts, Segregated Accounts and Protected Cell Accounts (Note 5)	69,943,679		69,943,679
Total Assets	\$ 708,031,537	\$ 2,424,081	\$ 705,607,456

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART THEREOF.

Protective Life and Annuity Insurance Company
Statement of Assets, Liabilities, Surplus and Other Funds
For the Year Ended December 31, 2003

Liabilities, Surplus and Other Funds

Liabilities:

Aggregate reserve for life contracts (Note 6)	\$ 452,710,435
Aggregate reserve for accident and health contracts (Note 7)	7,201,928
Liability for deposit-type contracts	3,254,905
Contract claims – Life	1,374,485
Contract claims – Accident and health	178,460
Policyholders' dividends	1,938
Provision for policyholders' dividends and coupons payable in following calendar year – estimated amounts, Dividends apportioned for payment to December 31, 2004	101,173
Premiums and annuity considerations for life and accident and health contracts received in advance less discount; including accident and health premiums	82,972
Provisions for experience rating refunds	273,163
Interest Maintenance Reserve	2,676,942
Commissions to agents due or accrued	17,600
Commissions and expense allowances payable on reinsurance assumed	1,788
General expenses due or accrued	4,359
Transfers to Separate Accounts due or accrued	(3,150,349)
Taxes, licenses and fees due or accrued, excluding federal income taxes	158,186
Current federal and foreign income taxes	702,883
Unearned investment income	1,787,728
Amounts withheld or retained by company as agent or trustee	17,116
Amounts held for agents' account including agents' credit balances (Note 8)	166,525
Remittances and items not allocated (Note 2) (Note 3)	6,031,205
Asset valuation reserve	6,707,119
Reinsurance in unauthorized companies	543
Funds held under reinsurance treaties with unauthorized reinsurers	95,860
Payable to parent, subsidiaries and affiliates	7,520,774
Funds held under coinsurance	46,762,354
From Separate Accounts Statement	69,943,679
Total Liabilities	\$ 604,623,771

Capital and Surplus:

Common capital stock	\$ 2,500,000
Preferred capital stock	2,000
Aggregate write-ins for other than special surplus funds	6,815
Gross paid in and contributed surplus	176,725,865
Unassigned funds (Note 9)	(78,250,992)
Total Capital and Surplus	\$ 100,983,688

Rounding

Total Liabilities and Stockholders' Equity

(3)
\$ 705,607,456

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART THEREOF.

PROTECTIVE LIFE AND ANNUITY INSURANCE COMPANY
SUMMARY OF OPERATIONS
For the Years Ended December 31, 2000, 2001, 2002, and 2003

000's omitted	2000	2001	2002	2003
Income:				
Premiums and annuity considerations for life and accident and health policies and contracts	\$62,668	\$59,070	\$47,502	\$30,004
Net investment income	30,509	32,821	31,688	37,015
Amortization of Interest Maintenance Reserve (IMR)	73	75	361	431
Separate Accounts net gain from operations excluding unrealized gains or losses	-1,751	-2,898	-2,747	3,181
Commissions and expense allowances on reinsurance ceded	284	394	1,006	136
Income from fees associated with investment management, administration and contract guarantees for Separate Accounts	113	126	122	137
Aggregate write-ins for miscellaneous income	298	11	204	747
Total Income	\$92,193	\$89,598	\$78,136	\$71,651
Deductions:				
Death benefits	\$ 9,598	\$ 9,863	\$ 9,008	\$10,453
Matured endowments (excluding guaranteed annual pure endowments)	33	16	38	83
Annuity benefits	73	32	56	68
Disability benefits and benefits under accident and health policies	1,452	2,084	1,815	1,804
Coupons, guaranteed annual pure endowments and similar benefits	18	15	12	11
Surrender benefits and withdrawals for life contracts	24,363	22,539	20,962	25,453
Interest and adjustments on policy or deposit-type contract funds	97	-75	150	310
Payments on supplementary contracts with life contingencies	2	2	2	2
Increase in aggregate reserves for life and accident and health policies and contracts	11,404	11,204	12,749	10,478
TOTALS	\$47,040	\$45,681	\$44,793	\$48,661
Commissions on premiums, annuity considerations and deposit-type contract funds (direct business only)	\$ 2,009	\$ 2,140	\$ 2,743	\$ 3,569
Commissions and expense allowances on reinsurance assumed	1,659	1,355	733	-1,888
General insurance expenses	6,925	7,012	6,876	8,027
Insurance taxes, licenses and fees, excluding federal income taxes	1,601	1,079	1,208	1,043
Increase in loading on deferred and uncollected premiums	-19	1	7	-56
Net transfers to or (from) Separate Accounts	18,422	17,807	9,336	-3,444
Aggregate write-ins for deductions	1,523	-1,945	278	318
TOTALS	\$79,159	\$73,130	\$65,974	\$56,230
Net gain from operations before dividends to policyholders and federal income taxes	\$13,033	\$16,469	\$12,162	\$15,420
Dividends to policyholders	114	106	105	29
Net gain from operations after dividends to policyholders and before federal income taxes and before realized capital gains or (losses)	\$12,919	\$16,363	\$12,057	\$15,321
Federal and foreign income taxes incurred (excluding tax on capital gains)				-45
Net gain from operations after dividends to policyholders and federal income taxes and before realized capital gains or (losses)	\$12,919	\$16,363	\$12,057	\$15,366
Net realized capital gains or (losses) less capital gains tax and transferred to the IMR	88	-2,467	-1,178	33
Net income	\$13,007	\$13,895	\$10,879	\$15,399

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART THEREOF.

PROTECTIVE LIFE AND ANNUITY INSURANCE COMPANY
CAPITAL AND SURPLUS
For the Years Ended December 31, 2000, 2001, 2002, and 2003

000's omitted	2000	2001	2002	2003*
Capital and surplus, December 31, prior year	\$ 32,147	\$ 31,878	\$ 34,354	\$102,551
Net income	13,007	13,895	10,879	15,399
Change in net unrealized capital gains or (losses)		-1,078	683	559
Change in net deferred income tax		31	3,124	-903
Change in nonadmitted assets and related items		-2,699	-314	436
Change in liability for reinsurance in unauthorized companies	-25	-32	36	20
Change in reserve on account of change in valuation basis, (increase) or decrease	246			
Change in asset valuation reserve	-746	2,580	-1,461	-5,028
Surplus withdrawn from Separate Accounts during period	-1,751	-2,898	-2,747	3,181
Other changes in surplus in Separate Accounts Statement	1,751	2,898	2,747	-3,181
Cumulative effect of changes in accounting principles		2,677		
Paid in surplus			70,000	
Dividends to stockholders	-12,750	-12,900	-14,750	-12,050
Net change in capital and surplus for the year	-268	2,476	68,197	-1,567
Capital and surplus, December 31, current year.	<u>\$31,878</u>	<u>\$34,354</u>	<u>\$102,551</u>	<u>\$100,984</u>

*Per Examination

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART THEREOF.

NOTES TO FINANCIAL STATEMENTS

Note 1 – Bonds

\$546,149,373

The above captioned amount is the same as reported in the Company's 2003 Annual Statement.

The examination indicated that the Company reviews prepayment assumptions for mortgage-backed securities on an annual basis. It was determined that the Company was not complying with SSAP No. 43, paragraph 10, which states, "For securities that have the potential for loss of a portion of the original investment due to changes in interest rates or prepayments, the review shall be performed at least quarterly."

The Report of Examination from the most recent examination performed by the Alabama Department of Insurance indicated that the actual acquisition cost and subsequent amortization of a November 18, 1998, securities acquisition was not accurately reported in the Company's financial statements. The Company made an attempt to correct the error by transferring cash plus interest in the amount of the error. However, no correction was made to correct the actual acquisition cost and subsequent amortization of the securities.

Due to the immateriality of this omission, no changes were made to the financial statements contained in this report.

Note 2 – Cash and short-term investments

\$14,253,494

Remittances and items not allocated

\$ 6,031,205

The above captioned amounts are the same as reported by the Company in its 2003 Annual Statement.

The Company had twelve bank accounts totaling \$(1,769,734) incorrectly classified in the Remittances and items not allocated line item at December 31, 2003. These accounts were incorrectly classified and should have been classified in the Company's Cash account in accordance with the NAIC Annual Statement Instructions. There was no effect on surplus due to this

misclassification. No changes were made in the financial statements for the misclassification.

Three individuals authorized on the Company's financial institution accounts were no longer affiliated with the Company at the examination date, December 31, 2003. These individuals were not promptly removed as authorized users from the Company's bank accounts.

<u>Note 3 – Uncollected premiums and agents'</u>	<u>\$ 3,945</u>
<u>balances in course of collection</u>	

<u>Remittances and items not allocated</u>	<u>\$6,031,205</u>
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The captioned amounts are the same as reported in the Company's 2003 Annual Statement.

The Company included \$2,595,084 for 2003 ceded reinsurance premiums in its Remittances and items not allocated line item at December 31, 2003, instead of in the Premiums and considerations: uncollected premiums and agents' balances in course of collection line item in accordance with the NAIC Annual Statement Instructions. No changes were made to the Company's 2003 financials due to no effect on the Company's surplus.

<u>Note 4 – Other amounts receivable under</u>	<u>\$314,475</u>
<u>reinsurance contracts</u>	

The above captioned amount is the same as reported in the Company's 2003 Annual Statement.

Included within this receivable was an \$18,020 receivable that was over a year old and still had not been recovered during the course of the examination. This receivable was estimated in December 2002 for premium taxes XL Life owed the Company. The intent of the treaty was for XL Life to not receive benefit from the reinsurance agreement. The Company has encountered difficulty in obtaining an analysis of XL Life's 2002 premium tax returns to determine how much benefit they received for the refunds on the business and a reimbursement for this benefit. This receivable should have been nonadmitted because it is not specifically identified as being an admitted asset in accordance with SSAP No. 4 paragraph 3, which states, in part, that a nonadmitted asset shall be defined as an asset which is "not specifically

identified as an admitted asset within the Accounting Practices and Procedures Manual.”

Due to immateriality, no changes were made to the financial statements contained in this report.

Note 5 – From Separate Accounts, Segregated **\$69,943,679**
Accounts and Protected Cell Accounts

From Separate Accounts Statement **\$69,943,679**

The captioned amounts are \$6,806,497 more than the \$63,137,182 reported for each in the Company's 2003 Annual Statement.

The Company did not comply with the requirement of Appendix A-255, paragraph 5 of the NAIC Accounting Practices and Procedures Manual, which requires that "as a minimum, the separate account liability will equal the surrender value based upon the market-value adjustment formula contained in the contract." In order to comply with A-255 paragraph 5, the examination adjustment involved the following: The Company's Separate Accounts Statement Aggregate reserve for life, annuity and accident and health contracts line item was increased by \$6,806,497 and the negative Aggregate write-ins for other than invested assets line item (market value adjustment) was adjusted to zero. This misclassification had no effect on surplus.

The Company did not complete the Rate Used to Obtain Fair Value column for nine securities in its 2003 Separate Accounts- Schedule D- Part 1. This omission was not in accordance with the NAIC Annual Statement Instructions.

Note 6 - Aggregate reserve for life contracts **\$452,710,435**

The captioned amount is \$7,754,629 more than the \$444,955,806 reported by the Company in its 2003 Annual Statement.

According to Alabama Insurance Department Regulation No. 85 Section 5 A. and B.,

A. No reinsurance agreement or amendment to any agreement may be used to reduce any liability or to establish any asset in any financial statement filed with this Department, unless the agreement, amendment

or a binding letter of intent has been duly executed by both parties no later than the "as of date" of the financial statement.

B. In the case of a letter of intent, a reinsurance agreement or an amendment to a reinsurance agreement must be executed within a reasonable period of time, not exceeding ninety (90) days from the execution date of the letter of intent, in order for credit to be granted for the reinsurance ceded.

The following treaties were not executed before the December 31, 2003, Annual Statement:

<u>Assuming Reinsurer</u>	<u>Reserve Credit</u>
ING Reinsurance, effective June 1, 2002	\$ 945,447
Swiss Re Life & Health America Incorporated, effective June 1, 2002	1,161,556
Swiss Re Life & Health America Incorporated, effective September 1, 2001	5,009,977
Swiss Re Life & Health America Incorporated, effective January 1, 2003	<u>637,649</u>
Total	\$7,754,629

Reserve credits totaling \$7,754,629, at December 31, 2003, shall not be allowed on the above agreements in accordance with Alabama Department of Insurance Regulation No. 85 Section 5.

Note 7 - Aggregate reserve for accident and **\$7,201,928**
health contracts

The above captioned amount is the same as reflected in the Company's 2003 Annual Statement.

The Company uses three reserving methods for its credit health insurance business. The actuarial examiner recalculated net unearned premium reserves on credit accident & health business using the Company's methods and again using the pro rata method as required by ALA. CODE § 27-36-5 (1975). The actuarial examiner compared the calculated reserve to that recorded by the Company. The actuarial examiner determined that the Company's net reserves were understated by approximately \$1.4 million.

The difference was determined to be caused by a difference in methodology. The Company's reserves were based on the pro rata, the rule of 78, and the mean of pro rata and rule of 78 approaches. The Company is not complying with Alabama statute requirements in their calculations of credit accident and health unearned premium reserves. The Company did not floor its reserves at pro-rata reserves. ALA. CODE § 27-36-5 (1975) requires that credit accident and health unearned premium reserves be set at a level that equals or exceeds a reserve calculated by the pro rata method.

Due to immateriality, no changes were made to the financial statements contained in this report.

<u>Note 8 – Amounts held for agents' account</u>	<u>\$166,525</u>
<u>including agents' credit balances</u>	

<u>Commissions to agents due or accrued</u>	<u>\$ 17,600</u>
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The above captioned amounts are the same as reported in the Company's 2003 Annual Statement.

In the 2003 Annual Statement, the Company reported its renewal commissions due to agents in the Amounts held for agents' account line item. The 2003 NAIC Annual Statement Instructions state for Amounts held for agents' account to include:

Agents' Credit Balances as well as any other amounts due or contingently due to agents (but not commissions, which should be included in line 10). Do not offset the debit balance of one against the credit balance of another.

The amount reported in the Amounts held for agents' account line item should have been reported in the Commissions to agents due or accrued line item. The misclassification has no effect on the Company's surplus. No change is reflected in the financial statements contained in this report due to this error in classification.

<u>Note 9 – Unassigned funds</u>	<u>\$(78,250,992)</u>
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The above captioned amount is \$7,754,629 less than the \$(70,496,363) reported in the Company's 2003 Annual Statement. The following is a reconciliation of unassigned funds per this examination:

Unassigned funds per Company		\$(70,496,363)
Examination increase/(decrease) to assets:		
From Separate Accounts, Segregated		
Accounts and Protected Cell Accounts	\$6,806,497	
Total Increase in Assets		\$ 6,806,497
Examination (increase)/decrease to liabilities:		
Aggregate reserve for life contracts	\$(7,754,629)	
From Separate Accounts Statement	(6,806,497)	
Total Increase to Liabilities		\$(14,561,126)
Total Unassigned Funds Per Examination		\$(78,250,992)

COMMENTS AND RECOMMENDATIONS

Management and Services Agreements – Page 7

It is recommended that the Company require it affiliates to comply with all provisions of its approved written agreements with affiliates.

Corporate Records – Page 13

It is recommended that the Company present its Investment Guidelines and amendments thereto to the Board of Directors for approval in accordance with ALA. CODE § 27-41-5 (1975).

Dividends to Stockholders – Page 19

It is recommended that the Company report to the Commissioner all dividends declared to shareholders within five business days in accordance with ALA. CODE § 27-29-5(g)(2) (1975).

Advertising and Marketing – Page 24

It is recommended that the Company establish and at all times maintain a system of control over the method of dissemination, content, and form of all advertisements of its policies in accordance with Alabama Insurance Department Regulation No. 69, § IV(2).

It is recommended that the Company's name be stated correctly on all advertisements, in accordance with Alabama Insurance Department Regulation No. 69 § V(6)(c).

Claims Processing – Page 25

It is recommended that the Company maintain all claims records, whether fully settled or pending, at its home office as required by ALA. CODE § 27-27-29(a)(1975).

Claims Review – Page 26

It is recommended that the Company complete Schedule F to include all resisted claims in accordance with the NAIC Annual Statement Instructions.

Reinsurance – Page 27

It is recommended that the Company identify and include each treaty by its original effective date in Schedule S in accordance with the NAIC Annual Statement Instructions.

Accounts and Records – Page 37

It is recommended that the Company maintain, at least on a quarterly basis, the outstanding detail that reconciles to the general ledger accounts, which reconcile to the Quarterly and Annual Statements in accordance with ALA. CODE § 27-27-29(a) (1975), which requires the Company to keep “complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary and suitable as to the kind, or kinds, of insurance transacted.”

It is recommended that the Company maintain complete records of its transactions at its home office in accordance with ALA. CODE § 27-27-29(a) (1975).

It is recommended that the Company maintain sufficient detail to substantiate all Annual Statement amounts in accordance with ALA. CODE § 27-27-29(a) (1975).

It is recommended that the Company respond to the examiner's information request within ten business days in accordance with Alabama Insurance Department Regulation No. 118 § 6.

Bonds – Page 47

It is recommended that the Company review the prepayment assumptions for its mortgage-backed securities at least on a quarterly basis in accordance with SSAP No. 43, paragraph 10.

It is recommended that the Company make the correction to its financial statements to reflect the subsequent amortization of the November 18, 1998, securities transaction recorded in error.

Cash and short-term investments and Remittances and items not allocated – Page 47

It is recommended that the Company classify all of its bank accounts in future financial statements in accordance with the NAIC Annual Statement Instructions.

It is recommended that the Company promptly update its authorizations for financial institution accounts when authorized signers retire, resign, or are terminated.

Uncollected premiums and agents' balances in course of collection and Remittances and items not allocated – Page 48

It is recommended that the Company reduce its Premiums and considerations: Uncollected premiums and agents' balances in course of collection asset line item by all ceded reinsurance premiums payable in accordance with the NAIC Annual Statement Instructions for its future financial filings.

Other amounts receivable under reinsurance contracts – Page 48

It is recommended that the Company nonadmit any receivable or asset that is not specifically identified as being admitted in accordance with SSAP No. 4, paragraph 3.

From Separate Accounts and Segregated Accounts and Protected Cell Accounts – Page 49

It is recommended that the Company record a separate accounts liability that is, at a minimum, equal to the surrender value based on the market value adjustment formula contained in the respective contracts in accordance with Appendix A – 255, paragraph 5 of the NAIC Accounting Practices and Procedures Manual.

It is recommended that the Company complete its Separate Accounts Statement Schedule D – Part 1 in accordance with the NAIC Annual Statement Instructions.

Aggregate reserve for life contracts – Page 49

It is recommended that the Company execute all reinsurance contracts before the “as of” date of the financial statement before it takes a credit related to the reinsurance contract in accordance with Alabama Insurance Department Regulation No. 85 Section 5.

Aggregate reserve for accident and health contracts – Page 50

It is recommended that the Company’s credit accident and health unearned premium reserves be set at a level that equals or exceeds a reserve calculated by the pro-rata method in accordance with ALA. CODE § 27-36-5 (1975).

Amounts held for agents’ account including agents’ credit balances and Commissions to agents due or accrued – Page 51

It is recommended that the Company properly classify its commissions due to agents in accordance with NAIC Annual Statement Instructions.

CONTINGENT LIABILITIES AND PENDING LITIGATION

The review of contingent liabilities and pending litigation included an inspection of representations made by management and a general review of the Company's records and files conducted during the examination, including a review of claims. These reviews did not disclose any items that would have a

material effect on the Company's financial condition in the event of an adverse outcome.

COMPLIANCE WITH PREVIOUS RECOMMENDATIONS

A review was made to determine if the Company had complied with the recommendations made in the last examination report. This review disclosed that the Company had complied with the recommendations contained in the immediately preceding Report of Examination with the exception of the items listed below.

Location of Claims Information

The previous Report of Examination recommended that the Company maintain all claims information, whether fully settled or pending, in its home office in accordance with ALA. CODE § 27-27-29(a)(1975). This examination noted that the Company did not comply with the recommendation. Further discussion of the claims records is included in this report under the caption "Claims Processing". Further discussion of the Company's permitted practice relative to claims information is included in this report under the caption "SUBSEQUENT EVENTS."

Reconciliation of Accounts

The previous Report of Examination recommended that the Company maintain, at least on a quarterly basis, a reconciliation of all of the general ledger accounts back to the outstanding transactions recorded in its Quarterly and Annual Statements. This examination noted that the Company did not comply with the recommendation. Further discussion of the general ledger accounts is included in this report under the caption "ACCOUNTS AND RECORDS – Lack of appropriate reconciliation of detail."

November 18, 1998, Securities Acquisition

The previous Report of Examination indicated that the actual acquisition cost and subsequent amortization of a November 18, 1998, securities acquisition was not accurately reported in the Company's financial statements. The Company made an attempt to correct the error by transferring cash plus interest in the amount of the error. However, no correction was made for the proper amortization of the securities.

Authorization for Investment Accounts

The previous Report of Examination recommended that the Company promptly update its authorizations for financial institution accounts when authorized signers retire, resign, or are terminated. This examination noted that three individuals, no longer affiliated with the Company at the examination date, were still authorized signers on the Company's bank accounts.

SUBSEQUENT EVENTS

The examiners reviewed general ledger and cash transactions occurring subsequent to the balance sheet date. In addition, examiners inquired of management regarding any significant subsequent events. Neither of these reviews disclosed any material subsequent events.

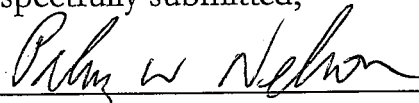
The examination noted that the Company was granted the privilege of maintaining certain source documents relating to pending claims in its claims office in Tennessee for the purpose of processing the claims and for a reasonable period of time after a claim is processed for the purpose of imaging the documents. The privilege was granted via a permitted practice letter from the Alabama Commissioner of Insurance dated November 8, 2001. The permitted practice approval expired on December 31, 2004. The examination noted that the aforesaid practices are continuing without the approval of the Commissioner. Further discussion on the location of the Company's claims information is included in this report under the captions "COMMENTS AND RECOMMENDATIONS – Claims Processing" and "COMPLIANCE WITH PREVIOUS RECOMMENDATIONS – Location of Claims Information."

CONCLUSION

The customary insurance examination procedures, as recommended by the National Association of Insurance Commissioners, have been followed in connection with the verification and valuation of assets and the determination of liabilities set forth in this report.

In addition to the undersigned, Rhonda Ball, Douglas Brown, Laura Chapman, Travis Crossland, Juliette Glenn, Theo Goodin, Evelyn Jones, Bobby McKinnon, Douglas Moseley, Danny Norton, Jayne Pearce, Shaun Sori, and Jimmy Thompkins, Examiners; and Julie Curry, FSA, MAAA, FLMI, Consulting Actuary; all representing the Alabama Department of Insurance, participated in this examination of Protective Life and Annuity Insurance Company.

Respectfully submitted,



Palmer W. Nelson, CFE

Examiner-in-charge

Alabama Department of Insurance

Southeastern Zone, NAIC